



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

Audit Report

Baviaans Municipality

1. Introduction

**REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL
LEGISLATURE AND THE COUNCIL ON THE BAVIAANS LOCAL MUNICIPALITY**
REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of the Baviaans Local Municipality set out on pages to, which comprise the statement of financial position as at 30 June 2012, the separate statement of financial performance, statement of changes in net assets and the cash flow statement for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2010 (Act No. 1 of 2010 as amended) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the General Notice issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my disclaimer of opinion.

Basis for disclaimer of opinion

Property, plant and equipment

6. The municipality has not applied the recognition and measurement that is required by the Standard of Generally Recognised Accounting Practice (GRAP) 17: *Property, Plant and Equipment* to its assets for the year ended 30 June 2012. It did also not maintain an adequate system of internal control or fixed asset register and sufficient audit evidence was not available to support assets amounting to R55,5 million (2011: R37,7 million). The municipality did furthermore not provide sufficient appropriate audit evidence to confirm existence of certain items of property, plant and equipment to the value of R 22 million. The municipality's accounting records did not permit the application of alternative audit procedures. Consequently, it was not possible to determine whether any adjustments to these amounts were necessary.

Value-added tax

7. The net value-added tax VAT receivable of R4,3 million, according to the general ledger, did not agree with the returns and refunds received from the South African Revenue Services (SARS) of R3,2 million, resulting in a difference of R1,1 million. Sufficient appropriate audit evidence was not available to explain this difference. Consequently, it was not possible to determine whether any adjustments to these amounts were necessary.
8. Section 7 of the Value-Added Tax Act, 1991 (Act No. 89 of 1991) prescribes that a vendor is liable for VAT for the supply of goods or services calculated at a rate of 14% on the value of the supply. Output VAT of R1.1 million, rather than R2 million should have been declared on VAT returns of the municipality.
9. Prior year adjustments to VAT were recorded and disclosed in the current year without restatement of the prior year. As a result of this the opening balances of VAT overstated by R3,2 million.

Trade and other payables

10. The trade payables of R13,1 million, in the sub-ledger did not reconcile to trade payables of R16,2 million disclosed in note 13 to the financial statements by R3,1 million. The municipality could not provide adequate supporting documentation or explanation for the difference of R3,1. In addition, the municipality did not provide sufficient appropriate audit evidence to support payments of R1,5 million made to suppliers after year-end. The municipality's accounting records did not permit the application of alternative audit procedures. Consequently, I was unable to determine whether any further adjustment to trade and other payables were necessary.

Trade and other receivables

11. Included in the trade receivables from exchange transactions of R3.7 million that disclosed in note 5 to the financial statements are amounts totalling R4,1 million for which adequate supporting documentation could not be provided. Consumer debtors' of R4 million in sub-ledger did also not reconcile to consumer debtors of R3,8 million that is disclosed in note 5 to the financial statements. The municipality could not provide adequate supporting documentation or explanations for the difference of R273 264. The municipality's accounting records did not permit the application of alternative audit procedures. Consequently, I was unable to determine whether any further adjustment to trade and other receivables is necessary.

Accumulated surplus

12. The municipality did not restate the opening balance on accumulated surplus for misstatements identified in the prior year financial year. The opening balance is overstated by R3,7 million.

Provisions

13. The post-employment medical benefit provision of R3,3 million, long service award provision of R525 538 and landfill rehabilitation provision of R324 500 as disclosed in notes 16 and 17 to the financial statements have been calculated by external parties. I was not able to obtain supporting documentation to confirm the accuracy of underlying data used in the calculations. Consequently, I was unable to determine whether any adjustments to provisions were necessary.
14. The municipality did not maintain adequate leave records which resulted it not being possible to provide support documentation for the leave pay provision of R1,3 million (2011: R1,1 million) that are disclosed in note 13 to the financial statements. The municipality's accounting records did not permit the application of alternative audit procedures. Consequently, I was unable to determine whether any adjustment to provisions were necessary.
15. The provision for legal fees of R300 000, that is disclosed in noted 13 to the financial statements, was raised during the 2010-11 financial year but was not utilised during the 2011-12 financial year and should therefore have been reversed. This provision is thus overstated by R300 000.
16. The valuation of the bonus provision of R1,1 million that is disclosed in note 16 to the financial statements by R611 850 as it was not based on accurate underlying data.

Personnel expenditure

17. Included in employee costs that are disclosed in note 28 to the financial statements are overtime expense and adjustments of R479 843 and R616 846, respectively, for which adequate supporting documentation could not be provided. The municipality's accounting records did not permit the application of alternative audit procedures. Consequently, I was unable to determine whether any further adjustments to personnel expenditure were necessary.

Conditional grants spending

18. Disclosed in the statement of financial position and note 15 to the financial statements are unspent conditional grants of R5,2 million (2011: R3,2 million). The disclosures relating to the individual grants did not agree with the underlying accounting records. Furthermore, adequate supporting documentation and explanations could not be provided by the municipality to support this unspent balance. Conditional grant funding also was utilised for operational expenditure. The municipality's accounting records did not permit the application of alternative audit procedures.

Unauthorised, irregular and fruitless and wasteful expenditure

19. The municipality did not have adequate systems in place to identify and disclose all irregular expenditure incurred during the year as required by section 112(1) of the MFMA. During the audit process the irregular expenditure of R694 529 (2011: R3,1 million) was detected. Due to the lack of systems it was impracticable to determine the full extent of the understatement of irregular expenditure that was not detected or

disclosed by the municipality. Consequently, I was unable to determine whether any further adjustments were necessary to the irregular expenditure disclosure note.

Cash flow statement

20. Presentation of a cash flow statement summarising the entity's operating, investing and financing activities, is required by GRAP 2: *Cash flow statements*. The cash flow statement contains a number of material inconsistencies within the financial statements. In addition, the cash flow statement presented does not cast and differs to the cash and cash equivalents note 8 to the financial statements by R200 451.

Contingencies and commitments

21. According to note 35 to the financial statements commitments amount to R22 million (2011: R20,5 million). According to records and supporting documentation the municipality has capital commitments of R9,9 million. Consequently, capital commitments as disclosed in note 35 are overstated by R12,1 million.
22. Restrictions on title to property, plant and equipment pledged as securities for liabilities should be disclosed in the financial statements for each class of property, plant and equipment recognised in the financial statements. The municipality assets pledged as security amount to R1,7 million. No assets pledged as security are disclosed in note 35..

Corresponding figures

23. During the 2011 financial year audit, I was unable to obtain sufficient appropriate audit evidence concerning:
- Employee related costs – R2,7 million
 - General expenses – R10,3 million
 - Special project expenditure – R1 million
 - Revenue – R4 million
 - Grant revenue – R2,2 million
 - VAT receivable – R1,3 million
 - Trade and other payables – R6,9 million
 - Cash and cash equivalents – R0,5 million
 - Provision for bad debts – R0,8 million
 - Trade and other receivables – R1,7 million
 - Unspent conditional grants – R2,2 million
24. I was unable to obtain sufficient appropriate audit evidence for the above by alternative means. Consequently I was unable to determine whether any adjustments to these amounts and the accumulated surplus were necessary. My audit opinion on the financial statements for the period ended 30 June 2011 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of these matters on the comparability of the current period's figures.

Aggregation/accumulation of immaterial uncorrected misstatements

25. The financial statements as a whole are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following elements making up the statement of financial position, statement of financial performance and the notes to the financial statements:
- Employee related costs are understated by R500 000

- Unspent conditional grants are overstated by R700 000

26. As a result, I was unable to determine whether any further adjustments to these elements were necessary.

Disclaimer of opinion

27. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on these financial statements.

Emphasis of matters

28. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Impairments

29. As disclosed in note 5 to the financial statements, impairments to the amount of R3.7 million were incurred as a result of a write-off of irrecoverable trade debtors.

Financial sustainability

30. While the municipality has prepared financial statements on a going concern basis, there are a number of indicators that its financial sustainability is under threat which has been disclosed in the accounting officers' report in the financial statements. This material uncertainty may cast significant doubt over the municipality's ability to continue as a going concern.

Conditional grant not spent in accordance with the purposes for which it was intended

31. The allocations for the Financial Management Grant, Municipal Systems Improvement Grant, Wireless Backbone Grant and the Valuation Grant were utilised in some instances for purposes other than those stipulated in their respective schedules or gazetted DoRA framework. This is a contravention of the requirements of section 15(1) of the DoRA.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

32. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

33. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages ... to ... of the annual report.

34. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned development priorities. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable,

specific, measurable and time bound) and relevant as required by the National Treasury's *Framework for managing programme performance information* (FMPPi).

35. The reliability of the information in respect of the selected development priorities or objectives is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

The material findings are as follows:

36. The municipal manager did not submit a copy of the IDP to the MEC for Local Government within 10 days after the adoption of the IDP by the municipal council as required by section 32 of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA).
37. The key performance indicators on the IDP do not include the following general key performance indicators as required per section 43 regulation 10 of the MSA:
- The percentage of households with access to basic level of water, sanitation, electricity and solid waste removal.
 - The percentage of households earning less than R1 100 per month with access to free basic services.
 - The percentage of a municipality's capital budget actually spent on capital projects identified for a particular financial year in terms of the IDP.
 - The number of jobs created through the municipality's local economic development initiatives including capital projects.
 - The number of people from employment equity target groups employed in the three highest levels of management in compliance with an approved employment equity plan.
 - The percentage of a municipality's budget actually spent on implementing its workplace skills plan.
 - Financial viability expressed by ratios.
38. The municipality did not prepare or submit a mid-year budget and performance assessment to the National Treasury and provincial treasury by 25 January 2012 as required by section 35 of the Municipal Budget and Reporting Regulation (GN 393 of 2009) (MBRR).
39. The internal auditors did not continuously assess and audit the performance measurement of the municipality and submit quarterly reports to the municipal manager as required section 14(1)(c) of the Municipal Planning and Performance Management Regulation (GNR 796 of 2011) (MPPMR).
40. The municipality did not indicate the measures taken to improve performance in their performance report as required by section 46(1) of the MFMA.

Conclusions

41. Based on my work described in this report, nothing has come to my attention that causes me to believe that the Baviaans Municipality's Annual Performance Report is not useful, in all material respects, in accordance with the predetermined criteria.
42. Based on my work described in this report, nothing has come to my attention that causes me to believe that the selected objectives set out in the Baviaans Municipality's Annual Performance Report is not fairly stated in all material respects, in accordance with the predetermined criteria.

Compliance with laws and regulations

43. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the general notice issued in terms of the PAA are as follows:

Strategic planning and performance management

44. The accounting officer of the municipality did not submit the results of the assessment on the performance of the municipality during the first half of the financial year to the mayor of the municipality, the National Treasury and the provincial treasury as required by section 72(1) (b) of the MFMA.

Budgets

45. Expenditure was incurred that was not budgeted for, in contravention of section 15 of the MFMA.
46. Quarterly reports were not submitted to the council on the implementation of the budget and the financial state of affairs of the municipality within 30 days after the end of each quarter, as required by section 52(d) of the MFMA.
47. Unforeseeable and/or unavoidable expenditure not provided for in the annual budget was incurred without being appropriated in an adjustment budget, in contravention of section 29(2)(d) of the MFMA .
48. The total unforeseen and unavoidable expenditure incurred exceeded 5% of own revenue, in contravention of section 72 of the MBRR.
49. Sufficient appropriate audit evidence could not be obtained that monthly budget statements were submitted to the mayor and the relevant provincial treasury, as required by section 71(1) of the MFMA.

Financial statements, performance report and annual report

50. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors were not adequately corrected, which resulted in the financial statements receiving a disclaimed audit opinion.
51. The municipality did not submit its financial statements within two months of the financial year-end to my office as is required by section 126(1)(a) of the MFMA. The municipal council was also not informed of this late submission of the annual financial statements as is required by section 133(1) of the MFMA.

Audit committee

52. The audit committee did not:

- advise the council, accounting officer and management staff on matters relating to internal financial control, accounting policies and performance evaluation as required by section 166(2)(a) of the MFMA
- review the annual financial statements to provide the council with an authoritative and credible view of the financial position of the entity, its efficiency and effectiveness

and its overall level of compliance with the MFMA, DoRA and other applicable legislation, as required by section 166(2)(b) of the MFMA

- meet at least four times a year, as required by section 166(4)(b) of the MFMA.

53. A performance committee was not in place and the audit committee established in terms of section 166 of the MFMA was not use for this function, as required by section 14 of the MPPMR.

Internal audit

54. The internal audit unit did not audit the performance measurements on a continuous basis and submit quarterly reports on their audits to the municipal manager and the performance audit committee, as required by section 14(1)(c) of the MPPMR.

Expenditure

55. The accounting officer did not take reasonable steps to prevent unauthorised expenditure, irregular expenditure and or fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

56. A total of R3,8 million of irregular expenditure was incurred in the current financial year as a result of the contravention of the SCM legislation. The root cause of the lack of effective prevention and detection is due to the bid evaluation committee not fully assessing the possibility of potentially prohibited transactions prior to considering the preferred candidates for the respective tenders.

57. An effective system of expenditure control, including procedures for the approval, authorisation, withdrawal and payment of funds, was not in place as required by section 65(2)(a) of the MFMA.

58. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.

59. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred and accounted for as required by section 65(2)(c) of the MFMA.

60. The municipality did not recover unauthorised, irregular or fruitless and wasteful expenditure from the liable person, as required by section 32(2) of the MFMA.

Revenue management

61. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system which recognised revenue when it is earned, accounted for debtors and receipts of revenue, as required by section 64(2)(e) of the MFMA.

62. Revenue received by the municipality was not always reconciled at least on a weekly basis, as required by section 64(2)(h) of the MFMA.

63. The valuation roll of the municipality was not regularly updated for changes to particulars in accordance with section 79 of the Municipal Property Rates, 2004 (Act No.6 of 2004).

Asset management

- 64. Adequate mechanisms, to ensure that internal controls and the accounting and information systems relating to asset management were insufficient in terms of section 63(2)(a) of the MFMA.
- 65. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained an effective system of internal control for assets (including an asset register) as required by section 63(2)(c) of the MFMA.

Conditional grants

- 66. The allocations for financial management grant, municipal systems improvement grant, wireless backbone grant and valuation grant were utilised in some instances for purposes other than those stipulated in their respective schedules or Gazetted DoRA framework in contravention of the requirements of section 15(1) of the DoRA.
- 67. Unspent conditional grant funds not committed to identifiable projects and not approved by the National Treasury for retention, were not surrendered to the National Revenue Fund, as required by section 20(1) of the DoRA.
- 68. The municipality did not disclose in its financial statements the purpose and amount of grants received from public entities, as required by section 31 of the DoRA.

Human resource management

- 69. The competencies of financial and SCM officials were not assessed promptly in order to identify an address gaps in competency levels, as required by section 13 of the Municipal Regulation on Minimum Competency Levels (MRMCL).
- 70. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and the relevant provincial treasury, as required by section 14(2)(a) of the MRMCL.
- 71. The annual report of the municipality did not reflect information on compliance with prescribed minimum competencies, as required by section 14(2)(b) of the MRMCL.

Procurement and contract management

- 72. Goods and services of a transaction value above R200 000 were not procured by means of inviting competitive bids. The value of these tenders awarded has been included in part A of section 3.
- 73. A contract was not awarded to a bidder that scored the highest points in the evaluation process, as required by of section 2(1)(f) of the Preferential Procurement Policy Framework, 2000 (Act No. 5 of 2000), but was incorrectly awarded to the bidder with the lowest price.
- 74. Awards were made to suppliers who did not submit a declaration of interest indicating if they are employed by the state or connected to any person employed by the state in accordance with section 13(c) of the SCM regulations.
- 75. Sufficient evidence could not be obtained to confirm that the prospective providers list for procuring goods and services through quotations was updated at least quarterly to include new suppliers that qualify for listing and prospective providers were not invited to apply for such listing at least once a year as per the requirements of sections 14(1)(a)(ii) and 14(2) of the SCM regulations.

Internal control

76. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for the qualified opinion, the findings on the annual performance report and the findings on compliance with laws and regulations.

Leadership

80. The leadership's direction and control over its resources to ensure that the reporting on financial matters, and compliance is carried out in a meticulous and efficient manner were insufficient. This deficiency impacted on the quality of reporting and led to information being provided that did not always have a high degree of credibility.
81. There was an over-reliance on consultants for the preparation of the financial statements of the municipality. The consultants together with the internal audit function, rather than leadership, took ownership of the process of preparing and reviewing financial statements. This inadequate involvement of leadership in the review processes resulted in amounts being included in financial statements that did not agree to underlying records or for which no supporting documentation could be provided.

Financial and performance management

82. The municipality did not introduce appropriate mechanisms, processes, procedures, systems or internal controls to ensure that transactions are correctly recorded, classified, reconciled, reported on in accordance with accounting framework (GRAP) with which the entity must comply or that they are in all respects accurate and complete.
83. Amounts that are reflected in financial statements and the annual performance report are not always fully supported by complete, relevant and inaccurate information. Record management is also not such that information is easily retrievable and available for audit purposes. This unsatisfactory financial management is further compounded by a general lack of review and monitoring that takes place.
84. The overriding root cause of the inability of the municipality to accurately record and provide support for financial transactions is that officials are not in all respects fulfilling their assigned duties and functions with the required diligence and enthusiasm.

Governance

77. The audit committee continues to play a limited role in governance matters. The audit committee issues the reports of internal audit to the council without making a direct contribution by informing the council or the oversight committee of its concerns and recommendation in terms of legislated mandate.

The audit committee does not promote accountability through evaluating and monitoring responses to risks and providing oversight over the effectiveness of the internal control environment including financial and performance reporting and compliance with laws and regulations.

East London

21 December 2012



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